Supreme Court, U.S.
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No. 08-1 08-758

IN THE

Supreme Court of the United States

UNITED STATES FIRE INSURANCE COMPANY,

Petitioner,

v.

GENERAL ELECTRIC CAPITAL CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1) Whether the Court below should have applied federal law as opposed to state law regarding a completing Miller Act surety's equitable right of subrogation arising out of a federal construction project thereby subjecting the right to federal funds for federal construction projects to the "vagaries of state law?"

2) Whether under federal law, U.S. Fire's equitable right of subrogation as the completing Miller Act surety in connection with a project owned by the U.S. Army Corps of Engineers, a federal governmental agency, extends to the U.S. Army Corps of Engineers' well established right and obligation to setoff its losses on one public construction project against funds remaining on a separate public construction project involving the same contractor?

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rules 14(b) and 29.6, the following corporate interests of United States Fire Insurance Company are disclosed:

Parents: Fairfax Financial Holdings Limited
FFHL Group, Ltd.
Fairfax, Inc.
Crum & Forster Holding, Inc.

No publicly held company owns 10% or more of United States Fire Insurance Company's stock.

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CITATIONS OF OFFICIAL AND UNOFFICIAL REPORTS OF OPINIONS AND ORDERS ENTERED IN THIS CASE

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United States v. Jesco Constr. Corp., No. 04-3488, 2006 U.S. Dist. LEXIS 7848 (E.D. La. March 1, 2006).

United States v. Jesco Constr. Corp., No. 04-3488, 2006 U.S. Dist. LEXIS 3363 (E.D. La. Jan. 30, 2006).

STATEMENT OF THE BASIS FOR JURISDICTION

This Court has jurisdiction over this matter pursuant to 28 U.S.C § 1254, which provides that "[c]ases in the court of appeals may be reviewed by the Supreme Court by . . . writ of certiorari." The order sought to be reviewed was entered by the United States Court of Appeals for the Fifth Circuit (the "Fifth Circuit") on May 14, 2008. (1a). Petitioner United States Fire Insurance Company's ("U.S. Fire") Petition for Rehearing was denied by the Fifth Circuit on September 11, 2008. (25a).

STATUTES AND REGULATIONS INVOLVED IN THE CASE

28 U.S.C. § 1254:

> Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:
>
> (1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;
>
> (2) By certification at any time by a court of appeals of any question of law in any civil or criminal case as to which instructions are desired, and upon such certification the Supreme Court may give binding instructions or require the entire record to be sent up for decision of the entire matter in controversy.

28 U.S.C. § 1335:

> (a) The district courts shall have original jurisdiction of any civil action of interpleader or in the nature of interpleader filed by any person, firm, or corporation, association, or society having in his or its custody or possession money or property of the value of $500 or more, or having issued a note, bond, certificate, policy of insurance, or other instrument of value or amount of $500 or more, or providing for the delivery or payment

or the loan of money or property of such amount or value, or being under any obligation written or unwritten to the amount of $500 or more, if

(1) Two or more adverse claimants, of diverse citizenship as defined in subsection (a) or (d) of section 1332 of this title [28 USCS § 1332], are claiming or may claim to be entitled to such money or property, or to any one or more of the benefits arising by virtue of any note, bond, certificate, policy or other instrument, or arising by virtue of any such obligation; and if

(2) the plaintiff has deposited such money or property or has paid the amount of or the loan or other value of such instrument or the amount due under such obligation into the registry of the court, there to abide the judgment of the court, or has given bond payable to the clerk of the court in such amount and with such surety as the court or judge may deem proper, conditioned upon the compliance by the plaintiff with the future order or judgment of the court with respect to the subject matter of the controversy.

(b) Such an action may be entertained although the titles or claims of the conflicting claimants do not have a common origin, or are not identical, but are adverse to and independent of one another.

28 U.S.C. § 1345:

> Except as otherwise provided by Act of Congress, the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress.

40 U.S.C. § 3131:

> (a) Definition — In this subchapter, the term "contractor" means a person awarded a contract described in subsection (b).
>
> (b) Type of Bonds Required — Before any contract of more than $100,000 is awarded for the construction, alteration, or repair of any public building or public work of the Federal Government, a person must furnish to the Government the following bonds, which become binding when the contract is awarded:
>
> (1) Performance bond — A performance bond with a surety satisfactory to the officer awarding the contract, and in an amount the officer considers adequate, for the protection of the Government.
>
> (2) Payment bond — A payment bond with a surety satisfactory to the officer for the protection of all persons supplying labor and material in carrying out the work provided for

in the contract for the use of each person. The amount of the payment bond shall equal the total amount payable by the terms of the contract unless the officer awarding the contract determines, in a writing supported by specific findings, that a payment bond in that amount is impractical, in which case the contracting officer shall set the amount of the payment bond. The amount of the payment bond shall not be less than the amount of the performance bond.

(c) Coverage for Taxes in Performance Bond —

(1) In general — Every performance bond required under this section specifically shall provide coverage for taxes the Government imposes which are collected, deducted, or withheld from wages the contractor pays in carrying out the contract with respect to which the bond is furnished.

(2) Notice — The Government shall give the surety on the bond written notice, with respect to any unpaid taxes attributable to any period, within 90 days after the date when the contractor files a return for the period, except that notice must be given no later than 180 days from the date when a return for the period was required to be filed under the Internal Revenue Code of 1986 (26 U.S.C. 1 et seq.).

(3) Civil action — The Government may not bring a civil action on the bond for the taxes—

(A) unless notice is given as provided in this subsection; and

(B) more than one year after the day on which notice is given.

(d) Waiver of Bonds for Contracts Performed in Foreign Countries — A contracting officer may waive the requirement of a performance bond and payment bond for work under a contract that is to be performed in a foreign country if the officer finds that it is impracticable for the contractor to furnish the bonds.

(e) Authority To Require Additional Bonds — This section does not limit the authority of a contracting officer to require a performance bond or other security in addition to those, or in cases other than the cases, specified in subsection (b).

48 C.F.R. § 1.104:

The FAR applies to all acquisitions as defined in part 2 of the FAR, except where expressly excluded.

48 C.F.R. § 2.101:

Acquisition means the acquiring by contract with appropriated funds of supplies or services (including construction) by and for the use of the Federal Government through

purchase or lease, whether the supplies or services are already in existence or must be created, developed, demonstrated, and evaluated. Acquisition begins at the point when agency needs are established and includes the description of requirements to satisfy agency needs, solicitation and selection of sources, award of contracts, contract financing, contract performance, contract administration, and those technical and management functions directly related to the process of fulfilling agency needs by contract.

48 C.F.R. § 32.603:

(a) If the contracting officer has any indication that a contractor owes money to the Government under a contract, the contracting officer shall determine promptly whether an actual debt is due and the amount. Any unnecessary delay may contribute to—

(1) Loss of timely availability of the funds to the program for which the funds were initially provided;

(2) Increased difficulty in collecting the debt; or

(3) Actual monetary loss to the Government.

(b) The amount of indebtedness determined by the contracting officer shall be an amount that—

(1) Is based on the merits of the case; and

(2) Is consistent with the contract terms.

48 C.F.R. § 32.611:

(a) The contracting officer shall insert the clause at 52.232—17, Interest, in solicitations and contracts unless it is contemplated that the contract will be in one or more of the following categories:

(1) Contracts at or below the simplified acquisition threshold.

(2) Contracts with Government agencies.

(3) Contracts with a State or local government or instrumentality.

(4) Contracts with a foreign government or instrumentality.

(5) Contracts without any provision for profit or fee with a nonprofit organization.

(6) Contracts described in Subpart 5.5, Paid Advertisements.

(7) Any other exceptions authorized under agency procedures.

(b) The contracting officer may insert the FAR clause at 52.232-17, Interest, in solicitations and contracts when it is contemplated that the contract will be in any of the categories specified in 32.611(a).

STATEMENT OF THE CASE

This appeal involves competing claims asserted by U.S. Fire and General Electric Capital Corporation ("G.E.") to funds interpled (the "Interpled Funds") by the United States of America acting by and through the U.S. Army Corps of Engineers ("Army Corps"), pursuant to 28 U.S.C. § 1345, in connection with a federal construction project awarded to Jesco Construction Corporation ("Jesco") for the construction of dikes on the Mississippi River (the "Mississippi Project"). The Interpled Funds were deposited with the United States District Court for the Eastern District of Louisiana in the matter captioned *United States v. Jesco Constr. Corp.*, No. 04-3488 (the "Interpleader Action").

G.E. entered into a loan agreement with Jesco, whereby Jesco granted G.E. a security interest in its accounts receivable. (9a). G.E.'s right to the Interpled Funds as a secured creditor, therefore, arises from and is no greater than the right of Jesco.

On or about May 9, 2001, the Army Corps awarded a federal construction contract (the "Charleston Contract") for the construction of certain maintenance dikes along the South Edisto River in Charleston, South Carolina (the "Charleston Project") to Jesco. (11a). Pursuant to the Miller Act, 40 U.S.C. § 3131, U.S. Fire,

as surety, issued a payment and performance bond (the "Bond" or "Miller Act Bond") on behalf of Jesco, as principal, in favor of the Army Corps, as owner, in connection with the Charleston Project. (11a). On or about September 27, 2002, the Army Corps terminated the rights of Jesco to proceed with the Charleston Contract and made demand on U.S. Fire to complete the Charleston Project under the Miller Act Bond. (11a). As a result of the Army Corps' claim, and in satisfaction of its obligations under the Bond, U.S. Fire incurred costs in excess of $800,000. (11a). As completing Miller Act surety, U.S. Fire is subrogated to the rights of the Army Corps.

U.S. Fire's entitlement to the Interpled Funds arises from its right of subrogation, including its right to assert the Army Corps' right to setoff its losses on the Charleston Project with the funds remaining on the Mississippi Project. "[T]here are few doctrines better established than that a surety who pays the debt of another is entitled to *all* the rights of the person he paid to enforce his right to be reimbursed." *Pearlman v. Reliance Insurance Co.* 371 U.S. 132, 137-138 (1962) (emphasis added); *see Henningsen v. U.S. Fid. & Guar. Co.*, 208 U.S. 404 (1908); *Prairie State Bank v. United States*, 164 U.S. 227 (1896). As such, U.S. Fire steps into the shoes of the Army Corps, gaining all of its rights. Just as the Army Corps was entitled to setoff its losses from the Charleston Project with the funds available from the Mississippi Project, U.S. Fire, through its equitable subrogation rights, is entitled to setoff the losses it incurred in completing the Charleston Project with the funds available from the Mississippi Project.

On December 6, 2005, G.E. filed a Motion for Partial Summary Judgment on its claim to the Interpled Funds. On December 13, 2005, U.S. Fire filed a Cross-Motion for Summary Judgment seeking a declaratory judgment that U.S. Fire is subrogated to the rights of the Army Corps as a result of the losses incurred in connection with the Charleston Project, and that U.S. Fire's right of equitable subrogation is superior to G.E.'s security interest. On January 30, 2006, the United States District Court for the Eastern District of Louisiana granted G.E.'s Motion for Partial Summary Judgment, and denied U.S. Fire's Cross-Motion for Summary Judgment.

On appeal, despite the fact that the dispute was over entitlement to federal funds arising from a federal construction project, the Fifth Circuit, *sua sponte*, erroneously held that the Interpleader Action was based on diversity jurisdiction and, thus, the law of the State of Louisiana was controlling. The Fifth Circuit held that Louisiana does not recognize a completing surety's equitable right of subrogation and, thus, G.E.'s secured claim took precedence to the Interpled Funds. U.S. Fire filed a Petition for Panel Rehearing of the Fifth Circuit's May 14, 2008, Opinion. By Order dated September 11, 2008, the Fifth Circuit denied U.S. Fire's Petition for Panel Rehearing.

This Petition seeks to have the Court review the Fifth Circuit's decision to apply state law as opposed to federal law when considering a completing surety's equitable right of subrogation arising out of a federal construction project involving federal funds. By applying state law, the Fifth Circuit decision improperly exposes

a completing Miller Act surety's equitable right of subrogation to federal funds from a federal construction project to the vagaries of state law.

This Petition also requests that the Court review whether U.S. Fire's equitable right of subrogation as the completing surety in connection with a project owned by the Army Corps, a federal governmental agency, extends to the Army Corps' well established right and obligation to setoff its losses on one public construction project against funds remaining on a separate public construction project involving the same contractor.

REASONS FOR GRANTING THE PETITION

I. Whether the Court below should have applied federal law as opposed to state law regarding a completing Miller Act surety's equitable right of subrogation arising out of a federal construction project thereby subjecting the right to federal funds for federal construction projects to the "vagaries of state law?"

As to the first question presented for review, despite the fact that the issue in dispute is related to the entitlement to federal funds arising from a federal construction project, in its May 14, 2008, Opinion, the Fifth Circuit, *sua sponte*, erroneously held that the dispute regarding entitlement to the funds interpled by the United States Government was based on diversity jurisdiction and, thus, the law of the State of Louisiana was controlling. As set forth herein, the Fifth Circuit had original jurisdiction because the case was filed

pursuant to 28 U.S.C. § 1345 and, thus, the Fifth Circuit was not bound by the law of the State of Louisiana and should have looked to the well established federal common law regarding a surety's equitable right of subrogation. By holding that state law regarding subrogation applies and, thus, denying U.S. Fire's subrogation argument, the Fifth Circuit decision is in conflict with the holdings of other circuits that have applied federal law to a subrogation claim arising out of a federal construction project. The Fifth Circuit decision exposes a Miller Act completing surety's right to federal funds for a federal construction projects to the "vagaries of state law."

A. Pursuant To 28 U.S.C. § 1345 The Fifth Circuit Had Original Jurisdiction, And Therefore *Erie R.R. Co. v. Tompkins* Is Not Applicable.

Jurisdiction for the interpleader complaint filed by the United States Government in the United States District Court for the Eastern District of Louisiana was based on 28 U.S.C. § 1345. That statute provides, in pertinent part, that "the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States." In its May 14, 2008, Opinion, the Fifth Circuit, however, erroneously held that jurisdiction was based on diversity.[1]

---

1. Although the Complaint cites to both 28 U.S.C. § 1335 and 28 U.S.C. § 1345 as the basis for jurisdiction, the correct basis for jurisdiction is 28 U.S.C. § 1345 because the United States Government was the filing party. Courts have recognized that "jurisdiction over an Interpleader Action brought by the (Cont'd)

When the United States invokes the jurisdiction of the federal courts under 28 U.S.C. § 1345, the holding in *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938), is not applicable and the Court is not bound by state substantive law. *See United States v. Williams*, 441 F.2d 637 (5th Cir. 1971); *United States v. Nationwide Mut. Ins. Co.*, 499 F.2d 1355 (9th Cir. 1974) (citing *Williams*, 441 F.2d at 637); *Reconstruction Fin. Corp. v. United Distillers Prods. Corp.*, 229 F.2d 665 (2d Cir 1956). As the Fifth Circuit itself has noted, where "jurisdiction of the District Court has been predicated on 28 U.S.C.A. § 1345 . . . the *Erie* rule requiring adherence to the appropriate substantive law of a particular state in diversity cases becomes inapposite." *Williams*, 441 F.2d at 643 (citing *Tri-State Ins. Co. v. United States*, 340 F.2d 637 (8th Cir. 1965)).

(Cont'd)

United States arises not under the interpleader statute (28 U.S.C. § 1335) cited in the Complaint, but rather under [the court's] general jurisdiction to hear actions commenced by the United States." *United States v. Armstrong*, 2007 WL 4438924, *5 (S.D. Ind. Dec. 17, 2007). Thus, "the requirements of § 1335 are not applicable" to an interpleader suit brought by the government. *Id.* (citing *United States v. Coumantaros*, 146 F. Supp. 51, 52-53 (S.D.N.Y. 1956)).

As the court in *Coumantaros* noted:

> Although the complaint states that it is filed under 28 U.S.C.A. § 1335, this statute is not the basis of the court's jurisdiction of this suit. The United States is not a 'person, firm, or corporation, association, or society' within the meaning of § 1335. Jurisdiction over the subject matter . . . exists in this court by virtue of 28 U.S.C.A. § 1345.

Coumantaros, 146 F. Supp. at 52-53.

In this case, the United States, as the party commencing the Interpleader Action, invoked the jurisdiction of the federal courts under 28 U.S.C. § 1345. Accordingly, the Fifth Circuit was not bound by the law of the State of Louisiana and, as set forth below, should have applied the well-settled federal common law regarding a surety's equitable right of subrogation.

B. The Fifth Circuit Should Have Applied Federal Law Regarding The Equitable Subrogation Rights Of A Miller Act Surety.

As set forth above, the Fifth Circuit erred when it determined that this action was a "diversity-based statutory interpleader case," and thus was bound to apply Louisiana law under the *Erie* doctrine. In actions brought under 28 U.S.C. § 1345, the Court must apply a different choice-of-law analysis than if this were an *Erie*-based diversity action. In actions brought under 28 U.S.C. § 1345, the court must "first determine whether there is an applicable federal rule. If there is a federal rule it must, of course, be applied." *United States v. Republic Ins. Co.*, 775 F.2d 156, 158 (6th Cir. 1985). State law should only be applied "in the absence of either a controlling federal rule or 'some federal interest sufficient to justify application of independent federal standards.'" *Id.* (citations omitted); *see Williams*, 441 F.2d at 643 (applying state law "in the absence of a contravening federal statute or policy").

1. Federal law clearly establishes a Miller Act surety's right to equitable subrogation.

In the present matter, the Fifth Circuit should have applied the well-established federal common law regarding a Miller Act surety's equitable right of subrogation.

The federal courts have consistently recognized a surety's rights to equitable subrogation for well over a century. "[T]here are few doctrines better established than that a surety who pays the debt of another is entitled to *all* the rights of the person he paid to enforce his right to be reimbursed." *Pearlman*, 371 U.S. at 137-138 (emphasis added); *see Henningsen*, 208 U.S. 404; *Prairie State Bank*, 164 U.S. 227. The equitable right of subrogation applies not only to sureties making payment under a payment bond, but also to those completing performance of a project under a performance bond.

> From *Prairie State Bank v. United States*, 164 U.S. 227, to *American Surety Co. v. Sampsell*, 327 U.S. 269, [the Supreme Court has] recognized the peculiarly equitable claim of those responsible for the completion of building contracts to be paid from available moneys ahead of others whose claims come from the advance of money.

United States v. Munsey Trust Co., 332 U.S. 234, 240 (1947). As the Fifth Circuit has itself recognized, in *Trinity Universal Ins. Co. v. United States*, 382 F.2d 317 (5th Cir. 1967), *cert. denied*, 390 U.S. 906 (1968),

when a surety completes the performance of a contract, the surety becomes subrogated not only to the rights of its principal, but more importantly, to the rights of the obligee to any retained funds.

Here, there is a clear conflict between Louisiana state law and federal law regarding a surety's equitable subrogation rights. The Fifth Circuit, in its May 14, 2008 Opinion, expressly noted that Louisiana has "consistently declined to recognize" claims for equitable subrogation. (4a) (citations omitted). Faced with such a conflict between the well-established federal law and Louisiana state law regarding a surety's equitable right of subrogation, the Fifth Circuit should have applied the well-established federal common law.

As this Court once cautioned, the "reasons which may make state law at times the appropriate federal rule are singularly inappropriate here." *Clearfield Trust Co. v. United States*, 318 U.S. 363, 367 (1943). Indeed, in this case, the "application of state law . . . would lead to great diversity in results by making *identical transactions subject to the vagaries of the laws of the several states.*" *Id.* (emphasis added). The Fifth Circuit's application of Louisiana law to determine the priority of the claims to federal contract funds is in essence a decision by the Fifth Circuit that G.E.'s secured interests in receivables trumped the United States' right to setoff, a right which is embodied in federal regulations and case law and stands irrespective of the particular state in which the project is located. *See* 48 C.F.R. §§ 32.611 and 32.603.

In addition to the conflict between Louisiana law and federal law regarding a surety's equitable right of subrogation, there is a conflict between the laws of the different states regarding a surety's equitable right of subrogation. The Fifth Circuit held that "under Louisiana law, G.E.'s perfected security interest takes precedent over the unsecured, un-perfected creditor's claim asserted by U.S. Fire." (4a). Other state courts, however, recognize that a surety's rights are superior to those of a bank with an assigned interest in the contractor's receivables. *See, e.g., Fidelity and Casualty Co. of N.Y. v. Central Bank of Birmingham*, 409 So. 2d 788 (Ala. 1982) (holding that surety was entitled to contract balances, not assignee bank); *United States Fid. & Guar. v. First State Bank of Salina*, 494 P.2d 1149 (Kan. 1972) (ruling that surety's subrogation rights are superior to bank's UCC filing); *Interfirst Bank Dallas v. United States Fid. & Guar. Co.*, 774 S.W.2d 391, 399 (Tex. Ct. App. 1989) (finding that "overwhelming and essentially unanimous post-UCC decisions have held that the interest of a surety . . . continues to be superior to the claim of a contract assignee, such as [a bank]"); *Lambert v. Maryland Cas. Co.*, 403 So. 2d 739 (La. Ct. App. 1981) (holding that surety subrogated to rights of owner in contract funds); *Third Nat'l Bank v. Highlands Ins. Co.*, 603 S.W.2d 730, 733 (Tenn. 1980) (recognizing that when surety performs as result of principal's default, "surety is subrogated to the rights of the contractor and the laborers and materialmen whose claims were paid to monies earned by the contractor before default, and this is so independently of assignments"); *Argonaut Ins. Co. v. C & S Bank of Tifton*, 232 S.E.2d 135, 139 (Ga. Ct. App.

1976) (recognizing that "overwhelming weight of case authority supports the conclusion that a surety's subrogation rights exist independently of Title 9 filing" of a bank). It is clear, therefore, that the Fifth Circuit's decision, if allowed to stand, would expose completing sureties on federal construction projects to the very risk that this Court cautioned against - "diversity in results by making identical transactions subject to the vagaries of the laws of the several states." *Clearfield*, 318 U.S. at 367.

2. The rights of U.S. Fire, as a Miller Act surety, should be decided under federal law.

Congress, in passing the Miller Act, did not intend "to repudiate equitable principles so deeply imbedded in our commercial practices, our economy, and our law as those spelled out in the *Prairie Bank* and *Henningsen* cases." *Pearlman*, 371 U.S. at 140. Moreover, as this Court has held, "[t]he Miller Act provides a federal cause of action, and the scope of the remedy as well as the substance of the rights created thereby is a matter of federal not state law." *F. D. Rich Co., Inc. v. U.S. for Use of Indus. Lumber Co., Inc.* 417 U.S. 116, 127 (1974).

This Court's rationale in *F. D. Rich Co.* is particularly instructive:

> Many federal contracts involve construction in more than one State, and often, as here, the parties to Miller Act litigation have little or no contact, other than the contract itself,

> with the State in which the federal project is located. The reasonable expectations of such potential litigants are better served by a rule of uniform national application.

Id.

In this case, it is undisputed that Jesco entered into a contract with the Army Corps for a federal project governed by federal regulations for the construction of certain dikes on the Mississippi River. (2a). Moreover, it is undisputed that U.S. Fire issued Miller Act bonds on behalf of Jesco, on a federal project which U.S. Fire was forced to complete. This is not a case where the Fifth Circuit needed to turn to state law for guidance due to a lack of federal law on the issue. Accordingly, the Fifth Circuit should have applied governing federal law to determine the outcome of the dispute, particularly where there are federal interests involved and where the law of Louisiana is in conflict with federal law and the law of other states.

II. Whether under federal law, U.S. Fire's equitable right of subrogation as the completing Miller Act surety in connection with a project owned by the U.S. Army Corps of Engineers, a federal governmental agency, extends to the U.S. Army Corps of Engineers' well established right and obligation to setoff its losses on one public construction project against funds remaining on a separate public construction project involving the same contractor?

As to the second question presented, it is well settled that "a surety who pays the debt of another is entitled to all the rights of the person he paid to enforce his to be reimbursed." *Pearlman*, 371 U.S. at 132; *see also Prairie State Bank*, 164 U.S. at 227. U.S. Fire's entitlement to the Army Corps' receivables on the Mississippi Project arises from its right of subrogation. As such, U.S. Fire steps into the shoes of the Army Corps, gaining all of its rights. Just as the Army Corps is entitled to setoff its losses from the Charleston Contract with the funds available from the Mississippi Contract, U.S. Fire, through its equitable subrogation rights, is entitled to setoff the losses it incurred in completing the Charleston Contract with the funds available from the Mississippi Contract.

A. U.S. Fire As Subrogee Of The Army Corps Is Entitled To Setoff Its Losses From The Charleston Project With The Remaining Funds From The Mississippi Project.

Had the Fifth Circuit properly applied federal law, it would have been constrained to hold that U.S. Fire's equitable subrogation rights, which are well-recognized by federal courts, extend to all of the rights of the Army Corps, the beneficiary of U.S. Fire's performance in completing the Charleston Project. *See Pearlman*, 371 U.S. at 137-38 ("a surety who pays the debt of another is entitled to *all* the rights of the person he paid to enforce his right to be reimbursed") (emphasis added). These rights of the Army Corps, to which U.S. Fire is subrogated, include the Army Corps' well-established right to setoff its losses on one project against its debts on another.

The government's common law right of setoff – which is inherent in the federal government – is broad, well-established, and "exists independent of any statutory grant of authority to the executive branch." *Marre v. United States*, 117 F.3d 297, 302 (5th Cir. 1997) (citing *United States v. Tafoya*, 803 F.2d 140, 141 (5th Cir. 1986)). "'The government has the same right which belongs to every creditor, to apply the unappropriated moneys of his debtor, in his hands, in extinguishment of the debts due to him.'" *Id.* (quoting *Munsey Trust Co.*, 332 U.S. at 239). The government's right to setoff can be defeated only by explicit language. *Johnson v. All-State Constr., Inc.*, 329 F.3d 848, 853 (Fed. Cir. 2003); *see also Applied Cos. v. United States*, 144 F.3d 1470, 1475 (Fed. Cir. 1998) ("it is well settled that the government retains its setoff

right unless there is some explicit statutory or contractual provision that bars its exercise"). The government's setoff right applies to government claims both under separate contracts, *William Green Constr. Co. v. United States*, 477 F.2d 930 (Ct. Cl. 1973), *cert. denied*, 417 U.S. 909 (1974), and under the same contract, *Cecile Indus., Inc. v. Cheney*,, 995 F.2d 1052 (Fed. Cir. 1993).

Furthermore, the government's right to setoff between contracts is established by the Federal Acquisition Regulations (the "FARs"), which apply to all government acquisitions, including construction contracts for government agencies. 48 C.F.R. § 2.101; *Pacord, Inc. v. United States*, 139 F.3d 1320, 1322 (9th Cir. 1998) (citing 48 C.F.R. § 1.104) (holding that the FARs applied to Navy's contract with contractor for repair of ships). "Section 2.101 defines 'acquisition' as 'the acquiring by contract . . . supplies or services by and for the use of the Federal Government' and includes 'contract performance, contract administration and those technical and management functions directly related to the process of fulfilling agency needs by contract.'" *Pacord*, 139 F.3d at 1322 (quoting 48 C.F.R. § 2.101).

The Charleston Contract was awarded by the Army Corps, a federal government agency, and, thus, is clearly subject to the FARs. Indeed, the Charleston Contract, by its own terms, is subject to the FARs, as the contract both recites specific provisions of the FARs and incorporates the FARs by reference.

Section 32.611 of the FARs sets forth the government's right and obligation to setoff. 48 C.F.R. § 32.611. That section, entitled "Routine Setoff," provides that a disbursing officer who is responsible for collection of a contract debt "shall make an appropriate setoff" against the contractor invoices on hand for payment. *Id.*

Additionally, the right to setoff "applies to all debts to the Government arising in connection with contracts and subcontracts for the acquisition of supplies or services." 48 C.F.R. § 32.603 (also specifying limited exceptions, none of which are applicable in the instant matter). By the plain language of Sections 32.611 and 32.603, once the government has notice of a contract debt, it is obligated to setoff that debt with any other contract debt; there is no limitation to government's right of setoff. *See Johnson*, 329 F.3d at 854.

In this matter, it is undisputed that had the Army Corps completed the Charleston Contract, it would have had the right and obligation to setoff its losses on the Charleston Project against its debt to Jesco on the Mississippi Project. As the Charleston Contract did not explicitly bar the Army Corps' right to setoff from other contracts, the Army Corps' setoff right cannot be limited solely to the Charleston Project. U.S. Fire, as subrogee of the Army Corps, is entitled to the same setoff rights as the Army Corps – the right to setoff its losses on the Charleston Project with the debt owed to Jesco on the Mississippi Project.

The oft-cited opinion of the Federal Circuit in *Transamerica Ins. Co. v. United States*, 989 F.2d 1188 (Fed. Cir. 1993), is directly on point. In *Transamerica*, the court held that where, as here, there is no competing governmental claim to the contract funds sought, the surety, pursuant to its equitable right of subrogation, can set off its performance bond loss with contract funds from a separate project involving the same governmental owner and the same contractor. *Id.* at 1194.

In *Transamerica*, as here, the Army Corps entered into two separate contracts with the same contractor. *Id.* at 1189. The contractor defaulted in connection with one of the contracts and the surety was required to complete that project. *Id.* The surety, pursuant to its equitable right of subrogation, sought to set off its performance loss with contract funds on the second project. *Id.* The surety argued that, because the Army Corps could have setoff any losses it incurred through completion of the first contract against the funds it owed the contractor from the second contract, the surety could, under equitable subrogation, step into the Army Corps' shoes and setoff the losses it incurred through completion of the same contract against these same funds. *Id.* The court in *Transamerica* sided with the surety, reasoning that, since the Army Corps could have setoff its losses against monies owed the contractor, the setoff rights of the equitably subrogated surety should be no less than those of the Army Corps, had the Army Corps completed the contract itself. *Id.* at 1194. U.S. Fire, here, is simply seeking to enforce the right clearly recognized in *Transamerica* – a surety's right, pursuant to its right of equitable subrogation, to set off its

performance bond loss with contract funds from another project involving the same governmental owner and the same contractor. *Id.*

The *Transamerica* court found that "the surety's equitable right of subrogation should be counterbalanced by the other interests involved. It is equitable in those situations to give the surety top priority only over funds related to the contract it completed." *Id.* By carefully distinguishing the facts of *Transamerica* from other cases where there was a competing governmental claim, *id.* at 1191-95 (citing *Dependable Ins. Co. v. United States*, 846 F.2d 65 (Fed. Cir. 1988); *Balboa Ins. Co. v. United States*, 775 F.2d 486 (Fed. Cir. 1985); *Ram Constr. Co. v. Am. States Ins. Co.*, 749 F.2d 1049 (3d Cir. 1984); *Western Cas. & Sur. Co. v. Brooks*, 362 F.2d 486 (4th Cir. 1966); *Universal Sur. Co. v. United States*, 10 Cl. Ct. 794 (1986); *Security Ins. Co. v. United States*, 428 F.2d 838 (Ct. Cl. 1970)), the *Transamerica* court made clear that those "other interests" are governmental interests, not the interests of creditors of defaulting principals, such as G.E. here. The *Transamerica* court distinguished these other cases by noting that "none of the other cases cited had the same balance of equities at hand." *Transamerica*, 989 F.2d at 1194; *see Dependable*, 846 F.2d at 67-68 (surety's subrogation rights limited to retained funds on contract which generated surety's claim because of government's superior countervailing tax claim); *Ram Const.*, 749 F.2d at 1055 (surety's equitable subrogation rights did not extend to post-bankruptcy contract because city, who was owner of project, had no setoff rights to profits from post-bankruptcy contract); *Western Cas.*, 362 F.2d at 491 (surety's equitable subrogation rights did not extend

to retained funds on separate contract because surety was subrogated only to rights of laborers and materialmen it paid pursuant to a payment bond it had issued and because state statute prohibited state government, which was project owner, from possessing same setoff rights sought by surety).

Where, as here, there is no competing governmental interest to the funds, U.S. Fire has the right to setoff its losses on the Charleston Contract with the Interpled Funds based on its well-recognized right of subrogation. Furthermore, as set forth above, U.S. Fire's right to the Interpled Funds is superior to the rights of creditors of a defaulting principal, such as G.E. As the *Transamerica* court noted, "when there are no government claims to be counterbalanced, it would be against fairness and good conscience to allow the defaulting contractor to benefit . . . at the expense of the fully performing surety." *Transamerica*, 989 F.2d at 1195.

Any "balancing" of the competing interests of G.E., as a creditor of the defaulting principal, and U.S. Fire, as completing surety which is subrogated to the rights of the Army Corps, must be resolved in favor of U.S. Fire's superior right to the Interpled Funds. G.E.'s claim to these funds is undisputedly derivative of Jesco's rights and G.E. is thereby limited to only the rights of Jesco to the Interpled Funds. Had the Army Corps, rather than U.S. Fire, completed the Charleston Contract, the Army Corps would have had the right – in fact, the obligation – to setoff its losses on the Charleston Project against the funds from the Mississippi Project. Accordingly, the funds from the Mississippi Project

could not have been due and owing to either Jesco, the contractor, or G.E., whose rights as Jesco's creditor are no better than those of Jesco. *United States Fid. & Guar. Co. v. Housing Auth. of Town of Berwick*, 557 F.2d 482, 485 (5th Cir. 1977) (holding that because the owner has the obligation to use all available contract funds, including funds from another project, to offset any losses it incurs as a result of the contractor's default, no funds were available to the contractor or the assignee of the contractor's rights). As subrogee to all of the Army Corps' rights, U.S. Fire, enjoys the Army Corps' setoff right and is entitled to the Interpled Funds.

The Fifth Circuit's decision in the instant matter directly conflicts with its own decision in *Berwick*, where the Fifth Circuit held that a surety, by way of its equitable subrogation right, is entitled to offset its losses incurred in completing one project with the contract funds from another job involving the same owner and same principal. *Id.* at 482 (as against assignee of contractor's right to contract funds, surety had superior claim to retainage on contract as offset against surety's losses on other contract where surety completed performance following contractor's default). In *Berwick*, the Fifth Circuit made clear that an owner has the right to offset its losses on one project against funds remaining on another contract with the same principal and, as subrogee of all of the owner's rights, the surety has that same setoff right. *Id.* at 485. U.S. Fire, as subrogee, is entitled to that right to setoff to the same extent as the Army Corps.

The Second Circuit, in *In re Chateaugay Corp.*, 94 F.3d 772 (Fed. Cir. 1996), similarly recognized that the government's right to setoff belongs to a surety where that surety is subrogated to the rights of the government. There, the surety had issued a bond on behalf of its principal, a coal mine operator, and in favor of the United States Department of Labor ("DOL"), guaranteeing the payment of black lung disease benefits to mine workers. *Id.* at 774-75. The surety made more than $4 million in payments following the principal's bankruptcy and, accordingly, was subrogated to the rights of the DOL. *Id.* The surety sought to offset its losses against a sizable tax refund due its principal from the Internal Revenue Service ("IRS"), with the IRS asserting a competing claim to that refund. *Id.* In holding that the surety, as subrogee, enjoyed the same right of setoff as the DOL, the *Chateaugay* court clearly established that a surety's right as subrogee of the federal government's right to setoff, like U.S. Fire's right in the instant matter, is not limited by the bonds issued by the surety. *Id.* at 782 (fact that funds sought were unconnected with bond issued by surety was of no import). Even though U.S. Fire bonded only the Charleston Contract, its right to the Interpled Funds remains unrestricted.

Despite the federal courts' establishment that a surety, as subrogee of the government, is entitled to offset its losses on a contract on which it completed performance against retained funds on another contract between the same government owner and same contractor, the Fifth Circuit, here, erroneously chose to apply state law to a federal matter and, in doing so, reached a result incongruous with the well-established

federal precedent. The Fifth Circuit's decision in the instant matter simply cannot be reconciled with decisions of the other federal courts, which have uniformly applied federal law to subrogation claims arising out of federal construction projects and have recognized a surety's equitable subrogation rights to funds remaining on a contract other than that on which the surety incurred a loss.

This Court held, in the landmark surety case, *Pearlman v. Reliance*, that "there are few doctrines better established than that a surety who pays the debt of another is entitled to *all* the rights of the person he paid to enforce his right to be reimbursed." *Pearlman*, 371 U.S. at 137-38 (emphasis added). It is plain to see that the Fifth Circuit, in the instant matter, disregarded this well-established principle.

CONCLUSION

For the forgoing reasons, Petitioner respectfully requests the issuance of a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT FILED MAY 14, 2008

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 06-31007

UNITED STATES OF AMERICA,

Plaintiff,

v.

JESCO CONSTRUCTION CORPORATION, ET AL.,

Defendant.

UNITED STATES FIRE INSURANCE COMPANY,

Intervenor-Appellant,

v.

GENERAL ELECTRIC CAPITAL CORPORATION; PHOENIXCOR, INC.,

Intervenors-Appellees.

Before DeMOSS, DENNIS and OWEN, Circuit Judges.

DENNIS, Circuit Judge:

This is an appeal from a summary judgment of the United States District Court, Eastern District of

Louisiana, resolving claims in this statutory interpleader action filed pursuant to 28 U.S.C. § 1335. The United States commenced this action on behalf of its agency, the U.S. Army Corps of Engineers ("the Corps"), and deposited in the district court $230,000 owed by the Corps to Jesco Construction Company ("Jesco") for the construction of pile dikes on the Mississippi River between Baton Rouge and the Gulf of Mexico ("Mississippi River Project"). The United States named several defendants who adversely claimed authority to receive payment on behalf of Jesco.[1] However, two of Jesco's creditors intervened, each claiming a superior and exclusive right to the funds: (a) General Electric Capital Corporation ("G.E.") asserted a perfected U.C.C. security interest in Jesco's assets for the payment of substantial loans it made to Jesco for the purchase of dredge boats and other business purposes, and (b) United States Fire Insurance Company ("U.S.Fire"), Jesco's bonding company on a different Corps project in Charleston, South Carolina, ("Charleston, S.C.Project"), asserted an equitable subrogation claim against Jesco's assets by virtue of having paid for the completion of that project after Jesco

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1. The United States named as defendants: Jesco Construction Corporation, a Louisiana corporation; Jesco Construction Corporation of Mississippi, a Mississippi corporation; Osborn & Osborn A.P.L.C., a Louisiana corporation; R.A. Osborn, Jr., a person domiciled in Louisiana; and New Orleans Marine Services, Inc., a Louisiana Corporation. Because there are at least two adverse claimants of diverse citizenship and the amount in controversy exceeds $500, the diversity jurisdictional requirements of 28 U.S.C. § 1355 are met.

defaulted. G.E. and U.S. Fire filed cross-motions for summary judgment. Three of the named defendants filed no response, and two others supported the supremacy of G.E.'s claim. In ruling on the motions, the district court held that G.E.'s perfected security interest in the $230,000 due Jesco for its work on the Mississippi River Project had priority over U.S. Fire's claim to an interest in the funds. U.S. Fire appealed, and we AFFIRM for the reasons hereinafter assigned.

As the facts are not in dispute, we review the district court's summary judgment *de novo* to determine whether it was rendered according to law. *See Nationwide Mut. Ins. Co. v. Lake Caroline, Inc.*, 515 F.3d 414, 418 (5th Cir.2008). Louisiana's substantive law governs our decision because Louisiana is the forum state in this diversity-based statutory interpleader case,[2] and Louisiana's own law is the proper choice of law under the facts and its conflicts of law rules.[3] Although the parties disregarded Louisiana law in their written and oral arguments, they have not expressly chosen or clearly relied on the law of another state.[4] It is undisputed that under Louisiana U.C.C. law G.E. has a perfected security interest in the assets of Jesco, including the funds due Jesco deposited by the United

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2. *See Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487, 496, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941); *Erie R.R. v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938).

3. *See* La. Civ.Code arts. 3515, 3537.

4. *See* La. Civil Code art. 3540; *cf.* La. R.S. 10:1-301 *et seq.* (U.C.C.).

States in this interpleader action;[5] and that U.S. Fire has asserted only a common-law equitable subrogation claim, which the Louisiana courts have consistently declined to recognize.[6] Accordingly, we conclude that, under Louisiana law, G.E.'s perfected security interest takes precedent over the unsecured, un-perfected creditor's claim asserted by U.S. Fire.[7]

Further, even though U.S. Fire's claim might have been recognizable as a right of subrogation by operation of law under Louisiana Civil Code Article 1829(3),[8] that

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5. La.Rev.Stat. § 10:9-310(a) ("[A] financing statement must be filed to perfect all security interests....,"); La.Rev.Stat. § 10:9-322(a)(2) ("a perfected security interest or agricultural lien has priority over a conflicting unperfected security interest or agricultural lien in the same collateral").

6. *See Great Southwest Fire Ins. Co. v. CNA Ins. Co.*, 547 So.2d 1339, 1343 (La.App. 3 Cir.1989); *see also Hudson v. Forest Oil*, 372 F.3d 742, 748 (5th Cir.2004); *Society of Roman Catholic Church of Diocese of Lafayette, Inc. v. Interstate Fire & Cas. Co.*, 126 F.3d 727 (5th Cir.1997); *Institute of London Underwriters v. First Horizon Ins. Co.*, 972 F.2d 125, 127 (5th Cir.1992).

7. La.Rev.Stat. § 10:9-322(a)(2) ("a perfected security interest or agricultural lien has priority over a conflicting unperfected security interest or agricultural lien in the same collateral"); Thomas A. Harrell, *A Guide to the Provisions of Chapter Nine of Louisiana's Commercial Code*, 50 La. L.Rev. 711, 755 (1990) ("Perfected security interests have priority over unperfected ones.").

8. La.Civ.Code art. 1829(3) ("Subrogation takes place by operation of law . . . In favor of an obligor who pays a debt he owes with others or for others as a result of the payment.").

right would have entitled U.S. Fire only to avail itself of the action and any security of the Corps against Jesco arising from Jesco's default upon the Charleston, S.C. Project contract;[9] and it would have enabled U.S. Fire to recover from Jesco only to the extent of the performance U.S. Fire rendered to the Corps under that contract.[10] According to our legal and record research, Jesco's default upon the Charleston, S.C. Project contract created no security interest under Louisiana law that U.S. Fire could have obtained by subrogation to assert against the funds due Jesco for its performance of the Mississippi River construction work in Louisiana. Therefore, we conclude that U.S. Fire could have asserted as a legal subrogee, at most, only the right and action of an unsecured creditor [11] of Jesco

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9. La.Civ.Code art. 1826(A) ("When subrogation results from a person's performance of the obligation of another, that obligation subsists in favor of the person who performed it who may avail himself of the action and security of the original obligee against the obligor, but is extinguished for the original obligee.").

10. La.Civ.Code art. 1830 ("When subrogation takes place by operation of law, the new obligee may recover from the obligor only to the extent of the performance rendered to the original obligee. The new obligee may not recover more by invoking conventional subrogation.").

11. *See* La. Civ.Code art. 1826 ("When subrogation results from a person's performance of the obligation of another, that obligation subsists in favor of the person who performed it who may avail himself of the action *and security* of the original obligee against the obligor. . . .") (emphasis added); Saul

(Cont'd)

against the funds due for its work on the Mississippi River Project between Baton Rouge and the Gulf. As such, under Louisiana law, U.S. Fire's unsecured claim still would have been outranked by G.E.'s perfected security interest claim.

The magistrate judge, who undertook the arduous task of analyzing the tortuous argument of U.S. Fire based on the vagaries of the common-law equitable subrogation doctrine, concluded that U.S. Fire's argument lacked merit because its suggested application of equitable subrogation would yield an inequitable result in this case. We are inclined to agree, but we do not address the equitable subrogation doctrine here because it has been rejected by Louisiana courts. Under the applicable Louisiana law it is clear that G.E.'s perfected security interest claim takes precedence over U.S. Fire's unsecured claim.

For these reasons, the judgment of the district court is AFFIRMED.

(Cont'd)

Litvinoff, 5 Louisiana Civil Law Treatise § 11.1 (2d ed.) ("[T]hat action against the obligor is personal to the third person who has performed, in the sense that it arises directly in his own patrimony, and, more often than not, the credit for which that action may be brought neither enjoys a privilege nor is assured by a particular security, which clearly means that the third person's recourse against the obligor is exposed to the risk of the obligor's insolvency."); Saul Litvinoff, *Subrogation*, 50 La. L.Rev. 1143, 1145-46 (1990) (same).

APPENDIX B — ORDER AND OPINION ON MOTIONS OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF LOUISIANA DATED AND FILED JANUARY 30, 2006

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA

CIVIL ACTION

NO. 04-3488

SECTION "I" (2)

UNITED STATES OF AMERICA

VERSUS

JESCO CONSTRUCTION CORPORATION ET AL.

ORDER AND OPINION ON MOTIONS

Pending before the court in this interpleader action are (1) a Motion for Partial Summary Judgment filed by intervenor/claimants General Electric Capital Corp. and Phoenixcor, Inc. (collectively "GE"), Record Doc. No. 49, and (2) a Motion for Summary Judgment filed by intervenor/claimant United States Fire Insurance Company ("U.S. Fire"). U.S. Fire incorporated its opposition to GE's motion in its memorandum in support of its own motion. Record Doc, No. 52. GE filed a separate opposition to U.S. Fire's motion. Record Doc. No. 63. U.S. Fire received leave to file a reply memorandum. Record Doc. Nos. 66, 67. Intervenor/claimants Osborn & Osborn APLC and R.A. Osborn, Jr.

filed a memorandum in support of GE's motion for partial summary judgment and a memorandum in opposition to U.S. Fire's motion for summary judgment. Record Doc. Nos, 51, 62. GE and the Osborn claimants have entered into a settlement agreement as to the claims of the Osborn entities, in the event that GE prevails in its motion for partial summary judgment.

Neither the United States, Jesco Construction Corporation ("Jesco"), Jesco Construction Corp. of Mississippi ("Jesco Mississippi") nor New Orleans Marine Services, Inc. ("NOMS") filed any pleadings in connection with the pending motions.

This matter was referred to the undersigned magistrate judge for all proceedings and entry of judgment in accordance with 28 U.S.C. § 636(c) upon the written consent of all parties. Record Doc, No. 45.

The issue in the instant case, which appears to be one of first impression, is how to rank the competing claims of a perfected security interest holder and a surety who is subrogated to the rights of the United States Army Corps of Engineers (the "Corps"). GE had loaned money to Jesco, a construction contractor, and had perfected its security interest in Jesco's accounts receivable. The Corps admittedly owes Jesco $230,000 for Jesco's completion of a project for the Corps along the Mississippi River in Louisiana (the "Mississippi Contract"). GE claims a priority right to the funds, which the Corps has deposited in the registry of this court.

Appendix B

The surety, U.S. Fire, was *not* involved in the Mississippi Contract and has no connection whatsoever with project addressed in the Mississippi Contract. However, U.S. Fire issued a bond to guarantee Jesco's performance of its separate contract with the Corps to construct an unrelated project in Charleston, South Carolina (the "Charleston Contract"). After Jesco defaulted on the Charleston Contract, U.S. Fire completed the work in Charleston and became subrogated to the rights of the Corps. U.S. Fire claims that its right as subrogee to the Corps arising from the Charleston Contract primes GE's perfected security interest in the account receivable from the separate Mississippi Contract.

Having considered the complaint, the record, the submissions of the parties and the applicable law, and for the following reasons, **IT IS ORDERED** that GE's Motion for partial summary judgment is **GRANTED** and that U.S. Fire's motion for summary judgment is **DENIED**.

I. *THE UNDISPUTED FACTS*

The material facts are undisputed. Phoenixcor loaned Jesco $2,000,000 on February 11, 1998. Jesco granted a security interest in all of its accounts receivable to Phoenixcor to secure the loan. Phoenixcor perfected its security interest by filing a UCC-1 statement on March 27, 1998 and continued its perfected security interest by filing a supplemental financing statement on February 28, 2003.

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GE Capital Corporation acquired 100% of the outstanding stock of Phoenixcor on April 19, 1999. Phoenixcor remains a wholly owned subsidiary of GE Capital Corporation.

On September 7, 1999, GE Capital loaned Jesco $1,800,000, secured by a security interest in Jesco's accounts receivable. GE Capital perfected its security interest by filing two UCC-1 statements on October 1, 1999 and continued its interest by filing two supplemental financing statements on September 30, 2004.

After Jesco defaulted on its payment obligations to GE, GE obtained a judgment in its favor against both Jesco and Jesco Mississippi in the principal amount of $4,568,021.75, plus interest, costs and attorney's fees. More than $3,000,000 remains owing under the judgment.

On December 16, 1998, Jesco entered into the Mississippi Contract[1] with the Corps to perform works along the Mississippi River. After Jesco completed the project, it entered into a settlement agreement with the Corps on April 10, 2000, in which the Corps agreed to pay Jesco an equitable adjustment of $230,000.

Thereafter, Jesco entered into an indemnity agreement with U.S. Fire on July 28, 2000, in which Jesco agreed to indemnify U.S. Fire from all loss

1. Neither the Mississippi Contract nor the Charleston Contract is in the record.

incurred as a result of U.S. Fire's issuance of bonds on Jesco's behalf.

On May 9, 2001, Jesco entered into the Charleston Contract with the Corps to perform work in South Carolina. U.S. Fire issued a labor and material bond and a performance bond on Jesco's behalf for the Charleston Contract.

The Corps terminated Jesco from the Charleston project on September 27, 2002. U.S. Fire completed the project under its performance bond and suffered a net loss under that bond of more than $850,000. U.S. Fire also paid claims under its labor and materials bond in excess of $300,000. After filing suit, U.S. Fire received a judgment in its favor and against Jesco for more than $2,000,000.

The United States filed the instant interpleader and deposited the $230,000 owed to Jesco from the Mississippi Contract into the registry of the court. The United States named Jesco, Jesco Mississippi, Osborn and his law firm (which had represented Jesco in the settlement negotiations with the Corps over the Mississippi Contract) and NOMS (which has a judgment against Jesco) as defendants. U.S. Fire and GE intervened to assert their claims to the funds.[2]

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2. U.S. Fire and GE each received assignments of 50% of whatever rights that John Shavers, the sole shareholder of Jesco, might have in the interpleaded funds. However, neither U.S. Fire nor GE are relying on those assigned rights in the instant motions.

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II. *ANALYSIS*

A. *The Threshold Legal Principles*

It is undisputed that GE's perfected security interest in the $230,000 account receivable owed to Jesco by the Corps takes priority over the claim of an unsecured creditor. La Rev. Sta. §§ 10:9-201(a), 10:9-203(f), 9-310(a); *Capital Whse., Inc. v. Mayhall*, No. 97-1796, 1999 WL 643709, at *3 (E.D. La. Aug. 23, 1999) (Barbier, J.); *Tetra Applied Techs, Inc. v. H.C.E., Inc.*, 878 So. 2d 708, 712 (La. App. 3d Cir. 2004).

It is also undisputed that U.S. Fire, as surety for Jesco on the Charleston Contract and as a result of completing that project under its performance bond, is equitably subrogated to the rights of the Corps as owner on that contract. *Pearlman v. Reliance Iris. Co.*, 371 U.S. 132, 138 (1962);. *National Shawmut Bank v. New Amsterdam Cas. Co.*, 411 F.2d 843, 845, 848 (1st Cir. 1969); *Trinity Universal Ins. Co. v. United States*, 382 F.2d 317 (5th Cir. 1967).

"The right of subrogation is not founded on contract. It is a creature of equity; is enforced solely for the purpose of accomplishing the ends of substantial justice; and is independent of any contractual relations between the parties." *Pearlman*, 371 U.S. at 136 n.12 (quoting *Memphis L.R.R Co. v. Dow*, 120 U.S. 287, 301-02 (1887)). "And probably there are few doctrines bettor established than that a surety who pays the debt of another is entitled to all the rights of the person he paid to enforce his right to be reimbursed." *Id.* at 136-37.

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As air equitable subrogee of the Corps under the Charleston Contract, U.S. Fire has the same rights that the Corps would have had in any unpaid funds which Jesco had earned or which the Corps had retained pending completion of that contract. The subrogee of the owner has a priority right to earned and retained funds for that contract. This right primes a lender's perfected security interest in the contractor's assignment of the proceeds from the contract to the lender. *National Shawmut Bank*, 411 F.2d at 848 (citing *Pearlman*, 371 U.S. at 132; *Henningsen v. United States Fid. & Guar. Co.*, 208 U.S. 404 (1908); *Prairie State Nat'l Bank v. United States*, 164 U.S. 227, 235-36 (1896)).

The policy reason for elevating the subrogated surety above all other creditors is that, without the surety's performance, no funds would have been available to pay creditors at all. *Id.* at 849; *see Trinity Universal Ins. Co.*, 382 F.2d at 320 (The surety who completes the job "performs a benefit for the government, and has a right to the retained funds and remaining progress money to defray its costs."); *Fidelity & Deposit Co. v. Scott Bros. Constr. Co.*, 461 F.2d 640, 642 (5th Cir. 1972) ("But for the surety's completion of the work, the obligee on the bond, be he owner or prime contractor, would have been entitled to apply the funds against the cost of completion. It is the surety's performance which frees the funds, and, . . . the surety is entitled to them.") (quotation omitted).

U.S. Fire argues that it is subrogated to the right of the Corps to offset the $230,000 owed to Jesco under

the Mississippi Contract against the losses incurred by U.S. Fire in Completing the Charleston Contract. "The right of setoff is a 'common right, which belongs to every creditor, to apply the unappropriated moneys of his debtor, in his hands, in extinguishment of the debts due to him.'" *Chateaugay Corp. v. LTV Steel Co.*, 94 F.3d 772 (2d Cir. 1996) (quoting *Gratiot v. United States*, 40 U.S. (15 Pet.) 336, 370 (1841)).

A surety who pays under its labor and materials bond is subrogated to the rights of the contractor, not the government/owner, and is a creditor of the government for the amounts that the surety has paid under the bond. The government has the right to set off against the funds it owes the contractor any taxes owed by the contractor to the government, even though those taxes arise out of a different obligation than the construction contract. In these circumstances, the right of offset may be exercised by the government in priority to the right of the subrogated surety to the retained funds. *Trinity Universal Ins. Co.*, 382 F.2d at 320 (citing *Pearlman*, 371 U.S. at 132; *United States v. Munsey Trust Co.*, 332 U.S. 234 (1947)).

However, the surety's right as subrogee *of the government as owner* under the *performance* bond primes the right of the government to set off taxes owed to the government by the contractor, and the surety in this position is entitled to the retained funds without any offset. *Id.* The Fifth Circuit explained that the surety who completes the contract should not be in a worse position than if it had merely paid damages to the

government to finish the project. "If the government can set off the amount of the unpaid taxes when the surety has completed the job, the surety would be forced to work for less than the contract price. An equity court should attempt to avoid such an unfair result." *Id.* at n.8.

B. *Application of Legal Principles to Facts of the Instant Case*

The question in this case is whether GE's perfected security interest in the funds owed to Jesco by the Corps because of Jesco's completion of the Mississippi Contract takes precedence over, or is subordinate to, the rights of U.S. Fire, a surety who is subrogated to the Corps's rights, when that subrogation arises out of a wholly different and later contract between Jesco and the Corps. The parties agree that no prior cases have addressed this precise factual situation.

U.S. Fire relies on *United States Fidelity & Guar. Co. v. Housing Auth. of Town of Berwick*, 557 F.2d 482 (5th Cir. 1977), to assert that it ban recover funds attributable to a contract other than the one it performed when the same owner (the Corps) and the same contractor (Jesco) entered into two separate contracts. In *Berwick*, the Housing Authority for the Town of Berwick entered into two separate construction contracts, called "Job 2" and "Job 3" in the opinion, with Delta-General Construction Corporation. United States Fidelity and Guaranty Company ("USF&G") issued performance and payment bonds for both projects. Delta

later assigned its interest in the .outstanding retained funds from Job 2 to an insurance agency to secure a loan. *Id.* at 482.

After Delta defaulted on both contracts, USF&G completed both projects. The retained funds for Job 2 covered all of USF&G's losses on that project. After the Housing Authority paid USF&G for its losses, some $7,000 remained in the Job 2 retainage account. USF&G's losses on Job 3 exceeded the retained funds on that project. USF&G sought the $7,000 retainage from Job 2 to offset its Job 3 losses, while the insurance agency claimed the excess retainage based an Delta's assignment to it of the retained funds for Job 2. *Id.* at 482-84.

The Fifth Circuit found that USF&G was subrogated to the Housing Authority's rights as owner and that USF&G's rights prevailed over the insurance company's claim because the contract between the Housing Authority and Delta allowed the Housing Authority to "backcharge" retainage from *either* of the two projects to pay for labor and materials attributable to the other project. "As a result no 'final payment of retainage' ever matured or became due [to] Delta under the prime contract for Job-2." *Id.* at 484.

> Had USF&G not paid those sums [to complete the projects] under its bond, *the Authority had an express contract right* and statutory responsibility [FN3: Louisiana Public Works Act, R.S. 38:2243] *to use all of Delta's*

> *otherwise available contract funds, whether derived from Job-2 or Job-3*[,] to pay them. Consequently, there never was a debt owed by the Authority to Delta and, therefore, the assignment by Delta to the Agency does not preclude recovery by USF&G of the net excess retainage of $7,188 from Job 2. As stated in *P. P. Williams & Co. v. Roach*, 12 La. App. 305, 125 So. 465, 468 (1929), "(an) assignor can assign no better rights than he has, and the assignee, of course, acquires no better rights than the assignor has."

Id. at 485 (emphasis added).

The facts in *Berwick* are not sufficiently on point with those of the instant case to support U.S. Fire's argument. Unlike U.S. Fire, which completed only the Charleston Contract, USF&G in *Berwick* completed *both* contracts. Furthermore, when USF&G stepped into the Housing Authority's shoes as subrogee, it had the express contractual right to use the-retainage from Job 2 to offset its losses on Job 3. No such contractual provision that authorizes U.S. Fire to offset its losses on the Charleston Contract with the equitable adjustment owed to Jesco on the Mississippi Contract appears in the record of the instant case. In addition, in *Berwick*, Delta never earned, and the Housing Authority never owed to Delta, the final retainage for Job 2 because of Delta's default on that contract. However, in the instant case, Jesco completed the Mississippi Contract and negotiated an equitable adjustment of an

additional $230,000, which the Corps admittedly owes to Jesco. GE, as Jesco's assignee, has acquired a secured interest in those funds; which it has properly perfected.

U.S. Fire also relies on *Transamerica Ins. Co. v. United States*, 989 F.2d 1188 (Fed. Cir. 1993), In that case, the Corps of Engineers entered into two separate contracts with Bodenhamer Building Corporation to construct a school and a commissary. Transamerica Insurance Company bonded *both* projects. Bodenhamer defaulted on the school contract and Transamerica finished the school. Bodenhamer completed the commissary contract and received an equitable adjustment from the Corps of $500,000. Transamerica sought those funds to offset its losses on the school contract. *Id.* at 1189.

The Federal Circuit held that Transamerica, as subrogee of the Corps on the school contract, could recover the funds from the commissary contract in preference to the contractor. The government was only the stakeholder and had no interest in the funds it owed to Bodenhamer. The Federal Circuit observed that the only competing claim to the funds was that of the contractor who had defaulted and who should not be placed in a better position than the surety who had completed the school contract. *Id.* at 1194.

The court emphasized "the equitable nature of the right of subrogation" and quoted with approval from a state court case with similar facts, as follows:

> Fairness would dictate that the surety be accorded the owner's rights and remedies *with respect to the contractor.* In circumstances, like the present, where the same contractor is engaged in more than one project, it becomes clearer that it is the reach or scope of the remedy rather than the equitable right itself which is at issue. Finding no persuasive reasons to the contrary, we adopt the view that, "[t]he right of subrogation is not founded on contract. It is a creature of equity; is enforced solely for the purpose of accomplishing the ends of substantial justice; and is independent of any contractual relations between the parties."

Id. at 1192 (quoting *District of Columbia v. Aetna Ins. Co.*, 462 A.2d 428, 431 (D.C. Ct. App. 1983) (quoting *Memphis L.R.R. Co.*, 120 U.S. at 301-02)) (emphasis added).

U.S. Fire insists that "[t]he general rule is that 'a surety who pays the debt of another is entitled to *all the rights* of the person he paid to enforce his right to be reimbursed." *Id.* at 1194 (quoting *Pearlman*, 371 U.S. at 137) (emphasis added). U.S. Fire argues expansively that this language by the United States Supreme Court means that the surety, as subrogee of the Corps, succeeds to "all the rights" that the federal government

would have had against Jesco, including the right to set off the funds that the Corps owed to Jesco from the Mississippi Contract against any losses that the Corps would have incurred had it completed the Charleston Contract or, as in this case, U.S. Fire's losses incurred in completing the contract.

U.S. Fire reads entirely too much into the Supreme Court's words in *Pearlman*. The context in that case was a single contract between the government and the contractor. When the contractor went bankrupt and failed to pay the labor and materials costs of the project, the surety paid those costs. *Pearlman*, 371 U.S. at 133-34. The Court held that the surety was entitled to recover all of the retained funds held by the government that were owed to the contractor, as against the sole competing claim of the contractor's trustee in bankruptcy. *Id.* at 141. Again, that is not the instant case.

U.S. Fire also cites *Chateaugay Corp. v. LTV Steel Co.*,. 94 F.3d 772 (2d Cir. 1996), as an example of surety who became subrogated to the rights of a government agency without any limitations on the surety's right to setoff, such as a limitation that the obligation of the principal arise out of a single contract or that the government agencies between whom a setoff is sought be a single agency.

In *Chateaugay*, Aetna Casualty & Surety Co. issued a bond to a coal mine owner, LTV Steel Company, guaranteeing payments of black lung disease disability

benefits to LTV's employees. When LTV declared bankruptcy, Aetna paid the required disability benefits up to the maximum amount of its bond. Under federal taw, the Department of Labor ("DOL") continued to pay such benefits after the surety had exhausted its obligation; but the DOL retained the right to recover from LTV what the DOL had paid. Aetna claimed that it was subrogated to the DOL's right to set off its black lung payments against a tax refund owed to LTV by a different government agency, the Internal Revenue Service. *Id.* at 773-74.

The Second Circuit found that the DOL had a "longstanding common law right to set off debts owed to a citizen against that citizen's liability to the government" *Id.* at 777. Thus, the DOL "possesses a common law right to setoff its nontax debts against" the tax refund owed to LTV by the IRS and, because "Aetna is subrogated to any rights the DOL might have to recover funds from LTV Steel, . . . Aetna has an interest in the tax refund." *Id.* at 779. Based on this holding, U.S. Fire argues that there should be no limits on its subrogated right to exercise "all the rights" of the Corps against Jesco, including the Corps's right of setoff.

The fundamental flaw in all of U.S. Fire's arguments is that the result it seeks does not comport with the equitable nature of subrogation, under the undisputed facts of this case. In *Transamerica*, the Federal Circuit distinguished cases in which another entity had a competing interest to the funds, "None of the other cases cited had the same balance of equities at hand.

Each time; another interest beside that of the contractor took priority over the surety's claim." *Id.* at 1194.

This distinction is significant. The *Transamerica* court held that, when a competing interest exists, "the surety's equitable right of subrogation should be counterbalanced by the other interests involved. It is 'equitable' in those situations to give the surety top priority *only over funds related to the contract it completed.*" *Id.* at 1194 (emphasis added). GE's perfected security interest in a matured debt owed to Jesco that predates U.S. Fire's involvement with Jesco is just such a competing interest.

At least one federal district court and one state supreme court have rejected the concept that a subrogated surety under one contract has a priority right to recover funds from an unrelated contract between the same contractor and the same principal. Rather, the surety is an unsecured creditor as to the unrelated project.

These courts held that "'[p]riority based on equitable subrogation in one contract does not provide priority in excess funds from another contract.'" *In re Eastern Marine, Inc.*, 104 B.R. 421, 424 (N.D. Fl. 1989) (quoting *Transamerica, Inc. v. Barnett Bank*, 540 So. 2d 113, 117 (Fl. 1989)).

> In so holding, the Supreme Court of Florida expressly approved the dissent below which stated:

> [T]o the extent Transamerica [the surety] is claiming proceeds on construction contracts not covered by its bond based on the "dragnet" collateral provisions in its indemnity agreement with [the principal], or earned but unpaid construction funds held by the owner which exceed the surety's loss on a particular job, it appears Transamerica has left the safe haven of equitable subrogation for the posture of a contract assignee, or "conventional subrogation," and must jump the hurdles of having to perfect such a security interest under the [Uniform Commercial] Code.
>
> *Transamerica Insurance Co. v. Barnett Bank*, 524 So.2d 439, 450 (Fla. 5th DCA 1988) (dissenting opinion). This is the precise situation in this case; IINA [the surety] is also leaving the "safe haven" of equitable subrogation when it claims to have an equitable interest in anything other than the lighter vessel contract [for which it issued a bond]. For IINA to have a greater interest in [the contractor's] other assets than that of a general creditor, it had to "jump the hurdles" of having to perfect its security interest This it did not do.

Id.

In the instant case, U.S. Fire had nothing whatsoever to do with the Mississippi Contract, which was completed before U.S. Fire entered into its agreements with Jesco.

GE perfected its security interest in the proceeds of the Mississippi Contract long before U.S. Fire issued any bond to Jesco. The funds deposited in the registry of the court represent a fully matured debt owed to Jesco, and therefore to GE, by the Corps.

Subrogation is an equitable right. U.S. Fire has not cited any case in which the facts, or the equities, mirror those in the instant case. There would be nothing equitable about permitting U.S. Fire, which had nothing to do with the Mississippi Contract, to prime the properly and previously obtained secured interest of GE. Balancing the equities at hand in this case, I find that GE's perfected security interest in the funds primes any interest that U.S. Fire has by way of subrogation to the Corps.

CONCLUSION

For the foregoing reasons, **IT IS ORDERED** that the Motion for Partial Summary Judgment filed by General Electric Capital Corp. and Phoenixcor, Inc. is **GRANTED**. **IT IS FURTHER ORDERED** that the Motion for Summary Judgment filed by United States Fire Insurance Company is **DENIED**.

New Orleans, Louisiana, this 30th day of January, 2006.

s/ Joseph C. Wilkinson, Jr.
JOSEPH C. WILKINSON, JR
UNITED STATES MAGISTRATE JUDGE

APPENDIX C — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT DENYING PETITION FOR REHEARING FILED SEPTEMBER 11, 2008

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 06-31007

UNITED STATES OF AMERICA

Plaintiff

v.

JESCO CONSTRUCTION CORPORATION; ET AL

Defendant

UNITED STATES FIRE INSURANCE COMPANY

Intervenor - Appellant

v.

GENERAL ELECTRIC CAPITAL CORPORATION; PHOENIXCOR, INC

Intervenors - Appellees

ON PETITION FOR REHEARING

Before DeMOSS, DENNIS, and OWEN, Circuit Judges.

Appendix C

PER CURIAM:

IT IS ORDERED that the petition for rehearing is *Denied.*

ENTERED FOR THE COURT:

s/ James L. Dennis
United States Circuit Judge